

**REPORT OF THE AUDIT OF THE  
ESTILL COUNTY  
SHERIFF'S SETTLEMENT - 2014 TAXES**

**For The Period  
April 16, 2014 Through April 15, 2015**



**MIKE HARMON  
AUDITOR OF PUBLIC ACCOUNTS  
[www.auditor.ky.gov](http://www.auditor.ky.gov)**

**209 ST. CLAIR STREET  
FRANKFORT, KY 40601-1817  
TELEPHONE 502.564.5841  
FACSIMILE 502.564.2912**



**EXECUTIVE SUMMARY**  
**AUDIT OF THE**  
**ESTILL COUNTY**  
**SHERIFF'S SETTLEMENT - 2014 TAXES**

**For The Period**  
**April 16, 2014 Through April 15, 2015**

The Auditor of Public Accounts has completed the audit of the Sheriff's Settlement - 2014 Taxes for the Estill County Sheriff for the period April 16, 2014 through April 15, 2015. We have issued an unmodified opinion on the financial statement taken as a whole. Based upon the audit work performed, the financial statement is presented fairly in all material respects.

**Financial Condition:**

The sheriff collected 2014 taxes of \$4,428,469 for the districts, retaining commissions of \$177,752 to operate the sheriff's office. The sheriff distributed 2014 taxes of \$4,244,269 to the districts. No taxes are due to the districts from the sheriff and no refunds are due to the sheriff from the taxing districts.

**Report Comments:**

2014-001 Tax Collections Were Not Distributed By The Tenth Of Each Month  
2014-002 The Sheriff Did Not Make Daily Deposits  
2014-003 The Sheriff's Office Lacks Adequate Segregation Of Duties

**Deposits:**

The sheriff's deposits as of November 12, 2014 were exposed to custodial credit risk as follows:

- Uncollateralized and Uninsured \$313,452

The sheriff's deposits were covered by FDIC insurance and a properly executed collateral security agreement, but the bank did not adequately collateralize the sheriff's deposits in accordance with the security agreement.



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**MIKE HARMON**  
**AUDITOR OF PUBLIC ACCOUNTS**

To the People of Kentucky

Honorable Matthew G. Bevin, Governor  
William M. Landrum III, Secretary  
Finance and Administration Cabinet  
Honorable Wallace C. Taylor, Estill County Judge/Executive  
Honorable Gary Freeman, Estill County Sheriff  
Members of the Estill County Fiscal Court

Independent Auditor's Report

**Report on the Financial Statement**

We have audited the Estill County Sheriff's Settlement - 2014 Taxes for the period April 16, 2014 through April 15, 2015 - Regulatory Basis, and the related notes to the financial statement.

**Management's Responsibility for the Financial Statement**

Management is responsible for the preparation and fair presentation of the financial statement in accordance with accounting practices prescribed or permitted by the laws of Kentucky to demonstrate compliance with the Commonwealth of Kentucky's regulatory basis of accounting as described in Note 1. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of a financial statement that is free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the *Audit Guide for Sheriff's Tax Settlements* issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



To the People of Kentucky

Honorable Matthew G. Bevin, Governor

William M. Landrum III, Secretary

Finance and Administration Cabinet

Honorable Wallace C. Taylor, Estill County Judge/Executive

Honorable Gary Freeman, Estill County Sheriff

Members of the Estill County Fiscal Court

### **Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles**

As described in Note 1 of the financial statement, the financial statement is prepared by the Estill County Sheriff on the basis of the accounting practices prescribed or permitted by the laws of Kentucky to demonstrate compliance with the Commonwealth of Kentucky's regulatory basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statement of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

### **Adverse Opinion on U.S. Generally Accepted Accounting Principles**

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statement referred to above does not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of each fund of the Estill County Sheriff, as of April 15, 2015, or changes in financial position or cash flows thereof for the year then ended.

### **Opinion on Regulatory Basis of Accounting**

In our opinion, the financial statement referred to above presents fairly, in all material respects, the taxes charged, credited, and paid for the period April 16, 2014 through April 15, 2015 of the Estill County Sheriff, in accordance with the basis of accounting practices prescribed or permitted by the Commonwealth of Kentucky as described in Note 1.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated May 20, 2016 on our consideration of the Estill County Sheriff's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Estill County Sheriff's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Estill County Sheriff's internal control over financial reporting and compliance.

To the People of Kentucky

Honorable Matthew G. Bevin, Governor

William M. Landrum III, Secretary

Finance and Administration Cabinet

Honorable Wallace C. Taylor, Estill County Judge/Executive

Honorable Gary Freeman, Estill County Sheriff

Members of the Estill County Fiscal Court

**Other Reporting Required by *Government Auditing Standards* (Continued)**

Based on the results of our audit, we have presented the accompanying comments and recommendations, included herein, which discuss the following report comments:

2014-001 Tax Collections Were Not Distributed By The Tenth Of Each Month

2014-002 The Sheriff Did Not Make Daily Deposits

2014-003 The Sheriff's Office Lacks Adequate Segregation Of Duties

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike Harmon", with a stylized flourish at the end.

Mike Harmon

Auditor of Public Accounts

May 20, 2016

ESTILL COUNTY  
GARY FREEMAN, SHERIFF  
SHERIFF'S SETTLEMENT - 2014 TAXES

For The Period April 16, 2014 Through April 15, 2015

<u>Charges</u>	<u>County Taxes</u>	<u>Special Taxing Districts</u>	<u>School Taxes</u>	<u>State Taxes</u>
Real Estate	\$ 307,492	\$ 1,461,541	\$ 1,670,829	\$ 451,976
Tangible Personal Property	20,327	93,795	87,310	67,664
Fire Protection	2,753			
Increases Through Exonerations	102	481	550	149
Franchise Taxes	67,162	312,368	315,367	
Additional Billings	147	698	801	216
Limestone, Sand and Gravel Reserves	54	258	296	80
Oil Property Taxes	4,512	21,364	24,517	6,632
Penalties	2,595	12,231	13,882	3,930
Adjusted to Sheriff's Receipt	(8)	9	6	1
Gross Chargeable to Sheriff	<u>405,136</u>	<u>1,902,745</u>	<u>2,113,558</u>	<u>530,648</u>
<u>Credits</u>				
Exonerations	2,236	10,606	12,134	3,325
Discounts	4,737	22,272	25,076	7,517
Delinquents:				
Real Estate	14,679	69,447	79,442	21,490
Tangible Personal Property	382	1,764	1,642	1,375
Franchise Taxes	<u>24,042</u>	<u>108,911</u>	<u>112,541</u>	
Total Credits	<u>46,076</u>	<u>213,000</u>	<u>230,835</u>	<u>33,707</u>
Taxes Collected	359,060	1,689,745	1,882,723	496,941
Less: Commissions *	<u>15,260</u>	<u>70,770</u>	<u>70,602</u>	<u>21,120</u>
Taxes Due	343,800	1,618,975	1,812,121	475,821
Taxes Paid	343,292	1,616,577	1,809,403	474,997
Refunds (Current and Prior Year)	<u>508</u>	<u>2,398</u>	<u>2,718</u>	<u>824</u>
Due Districts				
as of Completion of Audit	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

\* Commissions:

4.25% on \$ 2,128,225

4% on \$ 417,521

3.75% on \$ 1,882,723

The accompanying notes are an integral part of this financial statement.

ESTILL COUNTY  
NOTES TO FINANCIAL STATEMENT

April 15, 2015

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

The sheriff's office tax collection duties are limited to acting as an agent for assessed property owners and taxing districts. A fund is used to account for the collection and distribution of taxes. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

B. Basis of Accounting

The financial statement has been prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a special purpose framework. Basis of accounting refers to when charges, credits, and taxes paid are reported in the settlement statement. It relates to the timing of measurements regardless of the measurement focus.

Charges are sources of revenue which are recognized in the tax period in which they become available and measurable. Credits are reductions of revenue which are recognized when there is proper authorization. Taxes paid are uses of revenue which are recognized when distributions are made to the taxing districts and others.

C. Cash and Investments

KRS 66.480 authorizes the sheriff's office to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Note 2. Deposits

The Estill County Sheriff maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). According to KRS 41.240, the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

ESTILL COUNTY  
NOTES TO FINANCIAL STATEMENT  
April 15, 2015  
(Continued)

Note 2. Deposits (Continued)

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the sheriff's deposits may not be returned. The Estill County Sheriff does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 66.480(1)(d) and KRS 41.240. As of April 15, 2015, all deposits were covered by FDIC insurance or a properly executed collateral security agreement. However, as of November 12, 2014, public funds were exposed to custodial credit risk because the bank did not adequately collateralize the sheriff's deposits in accordance with the security agreement.

- Uncollateralized and Uninsured      \$313,452

Note 3. Tax Collection Period

A. Property Taxes

The real and personal property tax assessments were levied as of January 1, 2014. Property taxes were billed to finance governmental services for the fiscal year ended June 30, 2015. Liens are effective when the tax bills become delinquent. The collection period for these assessments was September 11, 2014 through April 15, 2015.

B. Oil Taxes

The tangible property tax assessments were levied as of January 1, 2014. Property taxes are billed to finance governmental services for the fiscal year ended June 30, 2015. Liens are effective when the tax bills become delinquent. The collection period for these assessments was December 10, 2014 through June 16, 2015.

C. Limestone, Sand, and Gravel Taxes

The tangible property tax assessments were levied as of January 1, 2014. Property taxes are billed to finance governmental services for the fiscal year ended June 30, 2015. Liens are effective when the tax bills become delinquent. The collection period for these assessments was December 10, 2014 through June 16, 2015.

Note 4. Interest Income

The Estill County Sheriff earned \$26 as interest income on 2014 taxes. The sheriff distributed the appropriate amount to the school district as required by statute, and the remainder was used to operate the sheriff's office.

Note 5. Sheriff's 10% Add-On Fee

The Estill County Sheriff collected \$28,788 of 10% add-on fees allowed by KRS 134.119(7). This amount was used to operate the sheriff's office.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND  
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL  
STATEMENT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*





**MIKE HARMON**  
**AUDITOR OF PUBLIC ACCOUNTS**

The Honorable Wallace C. Taylor, Estill County Judge/Executive  
Honorable Gary Freeman, Estill County Sheriff  
Members of the Estill County Fiscal Court

**Report On Internal Control Over Financial Reporting And On  
Compliance And Other Matters Based On An Audit Of The Financial  
Statement Performed In Accordance With Government Auditing Standards**

**Independent Auditor's Report**

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Estill County Sheriff's Settlement - 2014 Taxes for the period April 16, 2014 through April 15, 2015 - Regulatory Basis and the related notes to the financial statement and have issued our report thereon dated May 20, 2016. The Estill County Sheriff's financial statement is prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a special purpose framework.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statement, we considered the Estill County Sheriff's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the Estill County Sheriff's internal control. Accordingly, we do not express an opinion on the effectiveness of the Estill County Sheriff's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying comments and recommendations, we identified a deficiency in internal control that we consider to be a material weakness and a deficiency that we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying comment and recommendation as item 2014-003 to be a material weakness.



Report On Internal Control Over Financial Reporting And On  
Compliance And Other Matters Based On An Audit Of The Financial  
Statement Performed In Accordance With *Government Auditing Standards*  
(Continued)

**Internal Control Over Financial Reporting (Continued)**

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying comment and recommendation as item 2014-002 to be a significant deficiency.

**Compliance And Other Matters**

As part of obtaining reasonable assurance about whether the Estill County Sheriff's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying comment and recommendation as item 2014-001.

**Sheriff's Responses to Findings**

The Estill County Sheriff's responses to the findings identified in our audit are described in the accompanying comments and recommendations. The Estill County Sheriff's responses were not subjected to the auditing procedures applied in the audit of the financial statement and, accordingly, we express no opinion on them.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Mike Harmon', with a long horizontal flourish extending to the right.

Mike Harmon  
Auditor of Public Accounts

May 20, 2016

## COMMENTS AND RECOMMENDATIONS



ESTILL COUNTY  
GARY FREEMAN, SHERIFF  
COMMENTS AND RECOMMENDATIONS

For The Period April 16, 2014 Through April 15, 2015

STATE LAWS AND REGULATIONS:

2014-001 Tax Collections Were Not Distributed By The Tenth Of Each Month

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The sheriff did not distribute all tax collections timely. The sheriff distributed franchise tax collections from the months of June, August, and September 2014 in January 2015. Additionally, franchise collections for the month of December 2014 were not distributed until the last week of January 2015. We also noted payments made several days late with regard to oil and gas tax collections. Payments not made timely appear to be an oversight by the Sheriff and his bookkeeper. Failure to make timely tax distributions is an issue of noncompliance that prevents taxing districts from receiving revenues timely and may cause cash flow issues for the taxing districts.

KRS 134.191(1) requires a sheriff to “provide monthly reports by the tenth day of each month to the chief executive of the county, the department, and any other district for which the sheriff collects taxes.” Further, KRS 134.191(3) provides “at the time of making the report, the sheriff shall pay to the county treasurer..., to the department, and to any other district for which the sheriff collects taxes, all funds belonging to the county, the state, or the district that were collected during the period covered by the report.” We recommend the sheriff provide monthly reports and distribute tax payments by the tenth day of each month as required by KRS 134.191.

*Sheriff's Response: No response.*

INTERNAL CONTROL - SIGNIFICANT DEFICIENCY:

2014-002 The Sheriff Did Not Make Daily Deposits

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The sheriff did not make deposits on a daily basis as required. During the month of December 2014, only two deposits were made into the tax account because the sheriff has not adopted a policy requiring daily deposits. The lack of daily deposits is an issue of non-compliance, and failure to make daily deposits increases the risk of undetected errors and fraud.

The Department for Local Government, under the authority of KRS 68.210, established minimum requirements for all local officials with regard to handling public funds and one of these requirements is “Daily deposits intact into a federally insured banking institution.” We recommend the sheriff start making daily deposits intact into a federally insured banking institution in order to comply with the Department for Local Government requirement and to reduce the risk of undetected errors and fraud.

*Sheriff's Response: I understand.*

ESTILL COUNTY  
GARY FREEMAN, SHERIFF  
COMMENTS AND RECOMMENDATIONS  
For The Period April 16, 2014 Through April 15, 2015  
(Continued)

INTERNAL CONTROL - MATERIAL WEAKNESS:

2014-003 The Sheriff's Office Lacks Adequate Segregation Of Duties

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The sheriff's office lacks adequate segregation of duties over receipts, disbursements, and reconciliations. The sheriff's bookkeeper receives payments for taxes, records receipts in the ledger, prepares bank deposits, and performs monthly bank reconciliations. Additionally, the same employee prepares checks for payments from the tax account, records disbursements in the ledger, and prepares monthly reports reflecting amounts to be paid to each taxing district. Having the same employee perform all these accounting functions increases the risk of undetected errors or fraud. The sheriff also uses a signature stamp which is kept in the office vault and is accessible to the bookkeeper. The lack of adequate segregation of duties is a result of a limited budget, which restricts the number of employees the sheriff can hire or delegate duties to.

Good internal controls dictate the same employee should not handle, record, and reconcile receipts. Further, the same employee should not be responsible for preparing, recording, and reconciling disbursements. Lack of adequate segregation of duties could result in the undetected misappropriation of assets and inaccurate financial reporting. The segregation of duties over various accounting functions such as opening mail, preparing deposits, recording receipts and disbursements, and preparing monthly reports, or the implementation of compensating controls is essential for providing protection from asset misappropriation and inaccurate financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

We recommend the sheriff segregate these duties or implement steps to strengthen internal controls through compensating controls such as:

- The sheriff should periodically compare the daily bank deposit to the daily checkout sheet and then compare the daily checkout sheet to the receipts ledger.
- The sheriff should compare the monthly financial reports to the receipts and disbursements ledgers for accuracy.
- The sheriff should periodically compare amounts due to districts per monthly reports to the payments to the taxing districts.
- The sheriff should periodically compare the monthly bank reconciliation to the balance in the checkbook.
- All disbursement checks should be signed by two people, one being the sheriff.
- The sheriff should personally mail or deliver tax payments to taxing districts.

All of these compensating controls could be documented by initialing and dating the documents used to perform the comparisons. If the sheriff chooses to use a signature stamp, it should be stored in a locked drawer only accessible by the sheriff and only used after the sheriff has approved supporting documentation for the disbursement.

*Sheriff's Response: I understand.*

